Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

DRSC

103. Sitzung IFRS-FA am 10.06.2021
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ASCG • Joachimsthaler Str. 34 • 10719

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Berlin, XX Month 2021

Dear Jean-Paul,

IASB Exposure Draft ED/2021/1 *Regulatory Assets and Regulatory Liabilities*

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to contribute to EFRAG's Draft Comment Letter (herein referred to as 'DCL') on the IASB's ED/2021/1 *Regulatory Assets and Regulatory Liabilities* (herein referred to as 'ED') by providing our feedback vis-à-vis the IASB.

We provide our response to EFRAG's questions to constituents in the appendix of this letter and attach our comment letter to the IASB, containing our detailed comments on the questions raised in the ED.

If you would like to discuss our comments further, please do not hesitate to contact Olga Bultmann (bultmann@drsc.de) or me.

Yours sincerely,

Sven Morich

Vice President

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Appendix – Answers to the questions in the DCL

Question 1 – Objective and scope

Have you identified any other situations in which the proposed scope would affect activities that you do not view as subject to rate regulation that give rise to regulatory assets and regulatory liabilities? If so, please describe the situations and why you consider they should not be within the scope.

We are not aware of any situations in which the proposed scope would affect activities that you do not view as subject to rate regulation that give rise to regulatory assets and regulatory liabilities. However, it should be noted that we have received very limited feedback from entities outside the utilities sector.

Have you identified any situations in which the proposed scope would include self-regulation? If so, please explain these situations. In your view, should such situations of self-regulation be included in the scope of the ED?

We are not aware of any situations in which the proposed scope would include self-regulation.

Do you think that there should be additional criteria (e.g., limited competition, regulator committed to support the financial viability through the rate-setting process, customer having no ability to avoid price increases) for eligibility to be within the scope of the proposed Standard?

We do not consider additional criteria for eligibility to be within the scope of the proposed Standard to be necessary.

Are you aware of examples of anomalous outcomes that could arise from the application of the scope of proposed Standard (e.g., recognition of currently excluded enforceable rights and obligations)?

We are not aware of examples of anomalous outcomes that could arise from the application of the scope of proposed Standard. However, we have concerns about the outcomes that could arise from the application of the detailed proposals on how an entity shall determine the components of the total allowed compensation for goods or services supplied in a period (paragraphs B3-B9 and B15). In this regard, please refer to our comments to question 3.

Question 3 – Total allowed compensation

In certain regulatory agreements, the regulator may entitle the entity to recover, as part of the regulatory rate, cost relating to construction before the asset is in operation and is being used to supply goods or services. How common are these type of agreements in your jurisdiction?

Since we are not aware of any German entities outside the energy sector that would fall within the scope of the ED, our response is limited to the energy sector.

In Germany, the entities regulated by the Federal Network Agency (Bundesnetzagentur) are entitled to charge to customers a regulatory return on the committed capital (return on capital) during the construction period. This corresponds to the procedure described in paragraph BC96(b) of the ED. The investments are defined and approved in the network expansion plan so that the regulatory return on the committed capital is certain. Even if – in the hypothetical case – the investment is not continued, this does not result in any obligation for the entity to deduct an amount in determining a regulated rate to be charged to customers in future periods.

Which of the two views (view 1 or view 2) on the treatment of regulatory returns on CWIP do you support and why?
View 1: EFRAG notes there are concerns on the proposed treatment of CWIP regulatory returns in situations where the regulatory agreement allows regulatory returns to be charged to customers during construction. The proposal departs from the alignment of the accounting treatment with the regulatory treatment of regulatory returns. EFRAG also highlights the operational challenges of recognising regulatory returns related to construction work in progress only when the asset is in use. Assets are applied on a portfolio rather than individual basis to generate revenue and it is difficult to attribute revenue to a single asset. Furthermore, some entities have high volumes of initiated assets under construction and high volumes of these that become operational- and it will be challenging for these entities to apply the proposed treatment of CWIP regulatory returns. View 2: EFRAG acknowledges that the IASB proposal will reflect total allowed compensation when the underlying asset is being used to provide goods or services and being consumed (through depreciation) and this will result in a faithful representation of profit patterns particularly for entities that have material and long-duration CWIP. For such entities, due to the proposed treatment of CWIP, the profit will be misleadingly understated when the asset becomes operational if the regulatory returns were to be recognised as part of the total allowed compensation during construction. Furthermore, EFRAG notes that the proposal will contribute to comparability across entities regardless of how regulatory return is structured within regulatory agreements.

We support the view 1. For our reasons for this view, please refer to our detailed comments on Question 3 in the comments letter to the IASB attached below.

Do you expect any implementation issues relating to the proposals in the ED to defer and recognise revenue from construction work in progress only in the operating phase?

Yes, we expect significant administrative and financial burden for entities to implement the proposals in the ED to defer and recognise revenue from construction work in progress only in the operating phase. In this respect, please refer to our detailed comments on Question 3 in the comments letter to the IASB attached below.

Question 4 – Recognition

Are you aware of situations where there is uncertainty regarding the existence of an enforceable right or enforceable obligation under a regulatory agreement, and if so, please describe these situations?

We are aware of situations where new legal requirements are created, and it is not yet sufficiently clear how these requirements will be included in the regulatory framework because negotiations with the regulator have not yet been completed. In these cases, judgement would be used to consider whether an enforceable right or an enforceable obligation exists.

Question 5 – Measurement

Do you consider that the guidance in the ED on the boundary of the agreement is understood in practice and can be applied without undue cost and effort? If not please provide examples of the possible challenges on determining the boundary of the regulatory agreement and assessing which cash flows to include in the measurement of regulatory assets and regulatory liabilities.

In the German regulatory system set by the Federal Network Agency (Bundesnetzagentur), the boundary of a regulatory agreement is not determined by the regulatory period. A regulatory period is followed by the next regulatory period. For this reason, from the perspective of the German utilities, rights and obligations arising from a regulatory agreement can already be judged enforceable, even if the prices are not set until a new regulatory period. Thus, we do not expect challenges on determining the boundary of the regulatory agreement.

Question 6 – Discount rate

Which of the two views on discounting do you support and why? View 1: Use the regulatory interest rate for regulatory assets and regulatory liabilities. The regulatory interest rate is negotiated with the regulator and considered objective by users. Supporters of this view disagree with the proposed application of a minimum adequate rate as the discount rate for regulatory assets, when the regulatory interest rate provided for a regulatory asset is insufficient. What matters ought to be the discount rate agreed with the regulator, as this represents the rate the entity is entitled to recover (fulfil) when measuring its regulatory assets and regulatory liabilities. Therefore, the application of a minimum adequate rate would not be relevant information for users to understand regulatory assets and regulatory liabilities. View 2: Discounting of regulatory assets and regulatory liabilities should follow the general discounting principles in IFRS Standards because the objective of discounting is to appropriately reflect the effects of the time value of money. The regulatory interest rate might have a different objective. In cases where there is a significant financing component and the regulatory interest rate differs from the market rate, an entity should apply the requirements in IFRS 15 and use the prevailing interest rates in the relevant market.

We support the view 1 to the extent that we consider the use of the regulatory interest rate to be appropriate to discount the estimated future cash flows in measuring regulatory assets and regulatory liabilities.

Regarding the proposed application of a minimum adequate rate as the discount rate for regulatory assets, currently, we do not see any practical relevance for German rate regulation in the event that the regulatory interest rate would not be sufficient.

Question 9 – Disclosure

In your view, which of the proposed disclosures in the ED should be prioritised (i.e., which of the disclosures are most useful and which are less useful)? Please explain.

In our view, a reporting entity should be allowed to judge for itself what specific disclosures need to be provided in order to meet the disclosure objectives. We note that entities use judgement to decide what information would be relevant for users of financial statements and hence, be sufficient to meet the proposed disclosure objectives. We therefore recommend that the detailed provisions included in paragraphs 78, 80, 81 and 83 be worded as examples of the possible disclosures to meet the objectives, rather than as mandatory provisions. Please refer to our comments on Question 9 in the comments letter to the IASB attached below.

Question 10 – Effective date and transition

Do you agree with the IASB decision to charge to goodwill and not to retain earnings all the adjustments to regulatory assets and liabilities resulting from the simplified treatment of the past business combinations? If not, what do you propose?

[Response is pending.]

Question 11 – Effective date and transition

Are you aware of examples of service concession arrangements falling under both the proposed Standard and IFRIC 12?

We are not aware of examples of service concession arrangements falling under both the proposed Standard and IFRIC 12.

Do you agree that the goodwill-related regulatory balances should not be reclassified to goodwill on the first-time adoption of IFRS Standards (proposed amendments to IFRS 1) but recognised as a separate subset of regulatory assets which should subsequently be amortised?

[Response is pending.]

What are your views about an approach where acquired regulatory assets (or liabilities) are not exempt from IFRS 3 and are measured at fair value and further discounted at adjusted regulatory interest rate in a manner similar to the provisions of IFRS 9?

[Response is pending.]